UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

BKY 4-89-2921

WILLMAR NURSING HOME,

Debtor.

DORRAINE MUND, as Trustee for the Bankruptcy Estate of Willmar Nursing Home,

Plaintiff,

ADV 4-91-14

-v.-

HERITAGE BANK, N.A.,

Defendant.

MEMORANDUM ORDER FOR JUDGMENT

At Minneapolis, Minnesota, August 21, 1991.

The above-entitled matter came on for oral argument before the undersigned on the 8th day of August, 1991 following the parties' submission of this proceeding on stipulated facts. The Plaintiff seeks to avoid the Debtor's collateral assignment of its vendor's interest in a contract for deed pursuant to 11 U.S.C. Section 544(a) and to avoid and recover the postpetition payments under the contract for deed, which the Defendant has been receiving and withholding, pursuant to 11 U.S.C. Sections 549(a) and 550(a)(1). Prior to the oral argument, the parties briefed whether the assignment of the vendor's interest in the contract for deed was avoidable, but neither party briefed recovery of postpetition payments withheld by the Defendant. The appearances were as follows: Phillip Kunkel for the Plaintiff; and Donald Spilseth for the Defendant. This Court has jurisdiction over the parties to and the subject matter of this proceeding pursuant to 28 U.S.C. Sections 157 and 1334, and Local Rule 201. Moreover, this Court may hear and finally adjudicate this proceeding because its subject matter renders such adjudication a "core" proceeding pursuant to 28 U.S.C. Section 157(b)(2)(K).

UNDISPUTED FACTS

The Debtor operated a nursing home in Willmar, Minnesota. On December 28, 1978, the Debtor conveyed the home and the land on which it is situated (the "Property") to Ker Pa Jo, Inc. (the "Vendee") through a contract for deed (the "Contract"). The Contract obligated the Vendee to pay the Debtor monthly installments of $5,224.73 for a term of 25 years. The Contract was recorded on January 27, 1982.

On April 15, 1983, the Debtor gave the Defendant a note in the original amount of $675,000 (the "Note") as evidence of a loan from the Defendant to the Debtor. On the same date, to secure payment of the Note, the Debtor executed a Mortgage and Assignment of Security Documents (the "Assignment"). The Assignment required the Vendee to tender payments directly to the Defendant, which applied it against the Debtor's monthly obligation under the Note and paid the balance to the Debtor. The Assignment was recorded on the same date. The Defendant, however, has never filed a financing statement regarding the assignment pursuant to Minnesota's enactment of Article Nine of the Uniform Commercial Code.

On June 22, 1989, the Debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. Following the filing of the petition, the Defendant has continued to receive and to withhold portions of the Vendee's payments.

II. DISCUSSION

A. Avoidance under 11 U.S.C. Section 544(a)

The controlling case on this issue appears to mandate judgment in favor of the Defendant on the Plaintiff's prayer for avoidance under 11 U.S.C. Section 544(a). Shuster v. Doane (In re Shuster), 784 F.2d 883 (8th Cir. 1986). In the Shuster case, the court of appeals held that recording a collateral assignment of a vendor's interest in a contract for deed is sufficient to perfect the assignee's interest in the real estate and the right to payments. Shuster, 784 F.2d at 885. The court of appeals reversed the holding of the district court, which had concluded that the parties had intended to create a security interest in "only the right to payments under the contract for deed." Shuster v. Doane (In re Shuster), 47 B.R. 920, 923 (D. Minn. 1985) (emphasis added), reversed, 784 F.2d 883 (8th Cir. 1986). The district court held that the assignment transferred no interest in real estate, and therefore perfection of the assignment was governed exclusively by Article Nine. The court of appeals held that the assignment transferred an interest in real estate, and therefore perfection of the assignment was governed exclusively by the real estate recording statutes. Shuster, 784 F.2d at 884.

Of central importance to the Shuster decision was the conclusion that "Minnesota courts consider the relationship between vendor and vendee in a sale of land by contract for deed analogous to that of mortgagor and mortgagee." Shuster, 784 F.2d at 885. Under Minnesota law, "the vendor in a contract for deed occupies a position substantially analogous to that of a mortgagee." State ex rel. Blee v. City of Rochester, 260 Minn. 151, 153-54, 109 N.W.2d 44, 45 (1961). That conclusion, however, does not compel the holding that an assignment of the right to payments under a contract for deed is perfected by recording. In fact, it may compel a contrary holding.

Perfection of a security interest in a note is governed exclusively by Article Nine of the Uniform Commercial Code, even if the note is secured by a properly recorded mortgage on real estate:

> An illustration of subsection (3) [Minn. Stat. Section 336.9-102(3)] is as follows:
>
> The owner of Blackacre borrows $10,000 from his neighbor, and secures his note by a mortgage on Blackacre. This Article [Minn. Stat. Section 336.9-101 et seq.] is not applicable to the creation of the real estate mortgage. Nor is it applicable to a sale of the note by the mortgagee, even though the mortgage continues to secure the note. However, when the mortgagee pledges the note to secure his own obligation to X, the Article applies to the security interest thus created, which is a security interest in an instrument even though the instrument is secured by a real estate mortgage. This Article leaves to other law the question of the effect on rights under the mortgage of delivery or non-delivery of the mortgage or of recording or non-recording of an assignment of the mortgagee's interest. See Section 9-104(j) [Minn. Stat. Section 336.9-104(j)]. But under Section 3-304(5) [Minn. Stat. Section 336.3-304(5)] recording of the assignment does not of itself prevent X

> from holding the note in due course.

Minn. Stat. Ann. Section 336.9-102 comment 4 (West Supp. 1991). See also McTevia v. Adamo (In re Atlantic Mortg. Corp.), 69 B.R. 321 (Bankr. E.D. Mich. 1987); Army Nat'l Bank v. Equity Developers, Inc., 245 Kan. 3, 774 P.2d 919 (1989). C.f. Peoples Bank v. McDonald (In re Maryville Sav. & Loan Corp.), 743 F.2d 413 (6th Cir. 1984), supplemental opinion, 760 F.2d 119 (6th Cir. 1985) (interpreting superseded version of Official Comment 4 to U.C.C. Section 9-102 to make Article Nine applicable to notes but not to deeds of trust securing notes). A security interest in a note is unperfected unless the secured creditor complies with the applicable provisions of Article Nine, regardless of whether any mortgage securing the note has been properly recorded.

A note is analogous to the provision in a contract for deed obligating the vendee to make installment payments to the vendor. Consequently, a collateral assignment of a vendor's right to payments, like a security interest in a note, should be unperfected unless the assignee complies with the applicable provisions of Article Nine, regardless of whether the assignment is recorded. Frearson v. Wingold (In re Equitable Dev. Corp.), 617 F.2d 1152 (5th Cir. 1980); Erickson v. Seattle Trust & Sav. Bank (In re Freeborn), 94 Wash. 2d 336, 617 P.2d 424 (1980). Contra Security Bank v. Chiapuzio, 304 Or. 438, 747 P.2d 335 (1987). This result seems eminently reasonable. It does not, however, end the analysis.

In most jurisdictions, a collateral assignment of a mortgage is unperfected, even if properly recorded, if the assignee does not perfect its security interest in the note secured by the mortgage by taking possession of the note as required by Article Nine:

> [I]t is an established tenant of real estate law that whoever has priority to the obligation has priority to the underlying mortgage; one follows the other. Therefore, in the absence of a statute expressly requiring delivery of the mortgage to an assignee, or recordation of a mortgage assignment, perfection and priority of a security interest in the note (by taking possession under Article Nine) should carry over to the mortgage incidental to it.

B. Clark, The Law of Secured Transactions under the Uniform Commercial Code   1.08[10][a], at 1-113 n.372 (2d ed. 1988) (citations omitted). See also McTevia, 69 B.R. at 325; Army Nat'l Bank, 245 Kan. at 19, 774 F.2d at 930; 55 Am. Jur. 2d Mortgages Section 1270 (1971). In such jurisdictions, a mortgage assignee does not acquire an interest in the mortgaged property superior to a holder in due course of the note secured by the mortgage by recording the mortgage assignment, since recording the assignment does not provide the constructive notice Article Nine requires to perfect a security interest in the note:

> But under Section 3-304(5) recording of the assignment does not of itself prevent X from holding the note in due course.

Official Comment 4 to U.C.C. Section 9-102. Recording a mortgage assignment might be necessary to perfect the assignee's interest in the real estate against creditors of the mortgagor, but not against creditors of the mortgagee. Army Nat'l Bank, 245 Kan. at 19, 774 P.2d at 930. Perfection of the mortgage assignment and the security interest in the note against creditors of the mortgagee is governed exclusively by Article Nine. Id.

Under Minnesota law, whether a mortgage assignee's failure to take possession of the note secured by the mortgage would render the recorded mortgage assignment unperfected is controlled by law other than the state's enactment of Article Nine:

> This Article [Minn. Stat. Section 336.9-101 et seq.] leaves to other law the question of the effect on rights under the mortgage of delivery or non-delivery of the mortgage or of recording or non-recording of an assignment of the mortgagee's interest.

Minn. Stat. Ann. Section 336.9-102 comment 4 (emphasis added). If Minnesota law holds that a recorded mortgage assignment is unperfected without perfection of the security interest in the note, and the same rule were applied to contracts for deeds, then the failure of an assignee to perfect its security interest in the vendor's right to receive payments under a contract for deed would render the assignment of the vendor's interest in the real estate unperfected against creditors of the vendor, even if the assignment were recorded. An assignee of a vendor's interest, however, might need to record the assignment to perfect its interest in the real estate against creditors of the vendee.

The court of appeals in Shuster was clearly correct when it concluded that a collateral assignment of a vendor's interest in a contract for deed transfers, inter alia, an interest in real estate:

> A few state courts have begun to take the position that the vendor's interest is simply a personal property interest--the right to receive the installment payments.
>
> This is a minority position and not the law in Minnesota.

Trondson v. Janikula, 458 N.W.2d 679, 682 (Minn. 1990) (emphasis added). The Minnesota Supreme Court, however, has recently made clear that a vendor's rights under a contract for deed can be separated into two distinct bundles: a right to receive payments, and an equitable lien on the land. Trondson, 458 N.W.2d at 683. Apparently, the court of appeals in Shuster was not asked to address whether a single assignment of both bundles of rights might require a different method of perfection for each bundle, nor whether a failure to perfect one bundle might render the assignment of the other bundle unperfected.

Furthermore, the validity of the Shuster decision is questionable in light of an opinion recently issued by the court of appeals. Mercantile Bank, N.A. v. Brown (In re Holiday Intervals, Inc.), 931 F.2d 500 (8th Cir. 1991). In the Brown case, the court of appeals held that a vendor's interest in a land sale contract constituted a "general intangible" rather than an "instrument" under Missouri's enactment of Article Nine, and therefore a security interest in the vendor's interest could not be perfected by possession of the contract. Id. at 503. The court did not address whether perfection was governed by Missouri's real estate recording statutes rather than Article Nine, even though, according to counsel for the Plaintiff, the Shuster decision was cited in the parties' briefs. Apparently, the court concluded that Article Nine controlled the issue:

> As a rule, "courts generally agree that the seller's interest under a land sale contract is a general intangible subject to Article Nine [of the U.C.C.]."

Id. at 502 (quoting 2 J. White & R. Summers, Uniform Commercial Code Section 23-7, at 274 (3d ed. 1988)).

The Shuster and Brown decisions are irreconcilable. They both address perfection of a collateral assignment of vendor's interest in a contract pursuant to which the vendor retains title to the property as security for the vendee's installment payment obligations. Furthermore, the relevant provisions of Minnesota's and Missouri's enactments of the Uniform Commercial Code are identical. See Minn. Stat. Sections 336.3-304(5), 336.9-102(3), and 336.9-104(j); Mo. Rev. Stat. Sections 400.3-304(5), 400.9-102(3), and 400.9-104(j). The court of appeals implicitly concluded in Brown that Article Nine controlled, notwithstanding that it had explicitly rejected that very same contention in its earlier Shuster opinion.

The Shuster decision, however has not been explicitly overruled by a subsequent decision of the court of appeals or a Minnesota appellate court, or by amendment to the relevant Minnesota statutes. Moreover, the facts of the instant case cannot be distinguished from those of the Shuster case. Consequently, I am compelled to hold that the Defendant's recording of the Assignment was sufficient to perfect its interest in both the Debtor's right to payments and the Property. Therefore, the Plaintiff is entitled to avoid neither of said interests pursuant to 11 U.S.C. Section 544(a).

B. Avoidance under 11 U.S.C. Section 549(a)

The parties' stipulation of facts characterizes the Assignment as having "assigned all right, title and interest in the Contract for Deed . . . to the Bank." This language appears to indicate that the Debtor had absolutely assigned its interest in the Contract to the Defendant. If such were the intent of the parties, the Defendant would be entitled to judgment under both 11 U.S.C. Sections 544(a) and 549(a), since an absolute conveyance of a vendor's interest in a contract for deed is perfected by recording. Trondson, 458 N.W.2d at 682-83. The parties' written and oral arguments, however, indicate that they agree that the transaction was intended to create a collateral rather than absolute assignment.

The Court is at a loss to explain why the Plaintiff permitted the Defendant to receive and withhold portions of such payments after the filing of the petition, since such payments constituted property of the estate even if they were subject to an unavoidable collateral assignment. The parties intended to create a collateral assignment, and therefore the Debtor retained an interest in the payments after it had assigned its right to payments to the Defendant. The Debtor's interest in the payments became property of the estate as of the commencement of the case. 11 U.S.C. Section 541(a)(1). The payments withheld by the Defendant are avoidable under 11 U.S.C. Section 549(a), since they constituted property of the estate and their transfer was not authorized by this Court. This holding, of course, may be of little value to the estate, since the recovered payments will still be subject to the Defendant's interest.

C. Sanctions under Fed .R. Bankr. P. 9011

The Plaintiff's complaint and memorandum were well grounded in fact and warranted by a good faith argument for the extension, modification, or reversal of existing law. There is no indication that said papers were interposed for any improper purpose. Consequently, the Defendant's request for sanctions under Rule 9011 of the Federal Rules of Bankruptcy Procedure is denied.

ACCORDINGLY, IT IS HEREBY ORDERED:

1. The Defendant shall have judgment declaring that the Debtor's assignment to the Defendant of the Debtor's right to receive payments under a contact for deed between the Debtor and Ker Pa Jo, Inc., which contract was dated November 30, 1981 and recorded May 28, 1982 in the office of the Kandiyohi County Recorder as Document No. 21929, is not avoided pursuant to 11 U.S.C. Section 544(a);

2. The Plaintiff shall have judgment declaring that all payments under said contract received and withheld by the Defendant after June 22, 1989 are avoided pursuant to 11 U.S.C. Section 549(a);

3. The Plaintiff shall have judgment against the Defendant in the amount of $100,709.44 ($3,873.44 per month for 26 months) plus prejudgment interest from the date each installment payment was received and withheld by the Defendant to the date the judgment is entered pursuant to 11 U.S.C. Section 550(a)(1);

4. By agreement of the parties, the Third Cause of Action of the Plaintiff's Complaint is dismissed with prejudice on the merits; and

5. The Defendant's request for sanctions under Fed. R. Bankr. P. 9011 is denied.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Nancy C. Dreher
United States Bankruptcy Judge